Report

of the

Examination of

Madison National Life Insurance Company

Middleton, Wisconsin

As of December 31, 1997

TABLE OF CONTENTS

December 7, 1998

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Commissioners:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

MADISON NATIONAL LIFE INSURANCE COMPANY

Middleton, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1993 as of December 31, 1992. The current examination covered the intervening period ending December 31, 1997, and included a review of such 1998 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employes' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance. They reviewed the adequacy of aggregate life and accident and health reserves, cash flow testing, and deferred and uncollected premiums for life insurance. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

II. HISTORY AND PLAN OF OPERATION

The company was organized in 1961, as National Security Life Insurance Company, and the name was subsequently changed to Madison National Life Insurance Company, Inc. (MNL). At the time of the previous examination, the company was a 100% owned subsidiary of The Madison Company (TMC), which was owned by Independence Holding Company (IHC). The creation of two companies (Independence Capital Corporation and Independence Financial Services Corporation) in 1993 and the merger of TMC and IHC in 1996 resulted in the current holding company structure shown in Section IV of this report. The changes in the holding company system had little effect on MNL's operations. The company's ultimate parent continues to be Geneve Holdings, Inc., which owns about 55% of IHC stock. An organizational chart and additional information on MNL's affiliates are included in the "Affiliated Companies" section of this report.

The company writes direct premium in the following states:

Wisconsin	$ 8,147,580	20.7%
Michigan	7,114,857	18.1
Minnesota	6,203,812	15.8
Texas	3,602,060	9.2
Indiana	2,945,983	7.5
Iowa	2,815,441	7.2
All others	8,530,310	21.5
Total	$39,360,043	100.0%

The company is licensed in the District of Columbia, the U. S. Virgin Islands, and all states except Maine, New Hampshire, New York, Rhode Island, and Vermont.

The company's business plan focuses on three areas: group insurance products, credit insurance products, and the acquisition of blocks of business. Major products marketed by the company include group long-term disability (LTD), group term life, credit disability, and credit life insurance. The direct business is marketed through 1,412 independent agents in 45 states. MNL also has in force some ordinary life policies which it discontinued marketing in 1984.

The acquisition of blocks of business from other insurers and guaranty associations is a significant part of the company's operations. The acquisitions have occurred through both 100% coinsurance and through assumption reinsurance. Major acquisitions are summarized in Section V of this report.

The following chart is a summary of the net insurance premiums written by the company in 1997. The growth of the company is discussed in the "Financial Data" section of this report.

Line of Business	**Direct Premium**	**Reinsurance Assumed**	**Reinsurance Ceded**	**Net Premium**
Life:				
Group term	$ 9,884,884	$	$ 5,244,425	$ 4,640,459
Credit	4,372,086	5,294,827	336,142	9,330,771
Ordinary	2,918,545	581,596	783,180	2,716,961
Individual annuities	222,754	1,958		224,712
Accident and Health:				
Credit	8,480,613	7,744,832	1,460,835	14,764,610
Group health and LTD	10,117,093	946,884	8,141,091	2,922,886
Group dental	2,397,227			2,397,227
Individual LTD	473,442		371,721	101,721
Other individual health	493,422		34,338	459,084
Total all lines	$39,360,066	$14,570,097	$16,371,732	$37,558,431

The company's surplus has been increased through the issuance of contribution notes in 1991 ($5 million), 1993 ($15 million), and 1996 ($5 million) totaling $25 million. With the issuance of the last note in 1996, the previous notes were amended so that all notes have an interest rate of 9 3/8% and mature at the end of 2007. All of the notes were issued to Independence Financial Services Corporation, the company's parent. In 1998 the notes were assigned to Independence Capital Corporation. The notes were issued with the consent of the Office of the Commissioner of Insurance. The purpose of the additional surplus was to allow the company to pursue larger blocks of business for acquisition. The company is current with regard to interest on the notes.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of four members who are annually elected by the shareholder to serve a one-year term. Officers are elected at the board's annual meeting. Members of the company's board of directors may also be members of other boards of directors in the holding company group. The board members currently receive no additional compensation for serving on the board.

Currently the board of directors consists of the following persons:

Name	Principal Occupation	Residence
Edward Netter	Chairman, Geneve Corporation	Greenwich, CT
Larry R. Graber	President, MNL	Austin, TX
Roy T. K. Thung	Sr. Vice President, Geneve Corporation	White Plains, NY
Steven B. Lapin	President, Geneve Corporation	Stamford, CT

Officers of the Company

The officers appointed by the board of directors and serving at the time of this examination are as follows:

Name	Office	Compensation
Larry R. Graber	President	$208,435 *
James R. Balgord	Senior Vice President	103,000
Murray A. Klein	Senior Vice President	112,452
Mark A. Musser	Vice President & Treasurer	102,500
Joel E. Myrold	Senior Vice President	100,000
Deirdre K. Ragan	Vice President	112,649 *
Richard E. Watts	Vice President	65,850
Kurt L. Goetzka	Assistant Vice President	62,500
Douglas D. Szudy	Assistant Vice President	55,900
David T. Kettig	Secretary	@

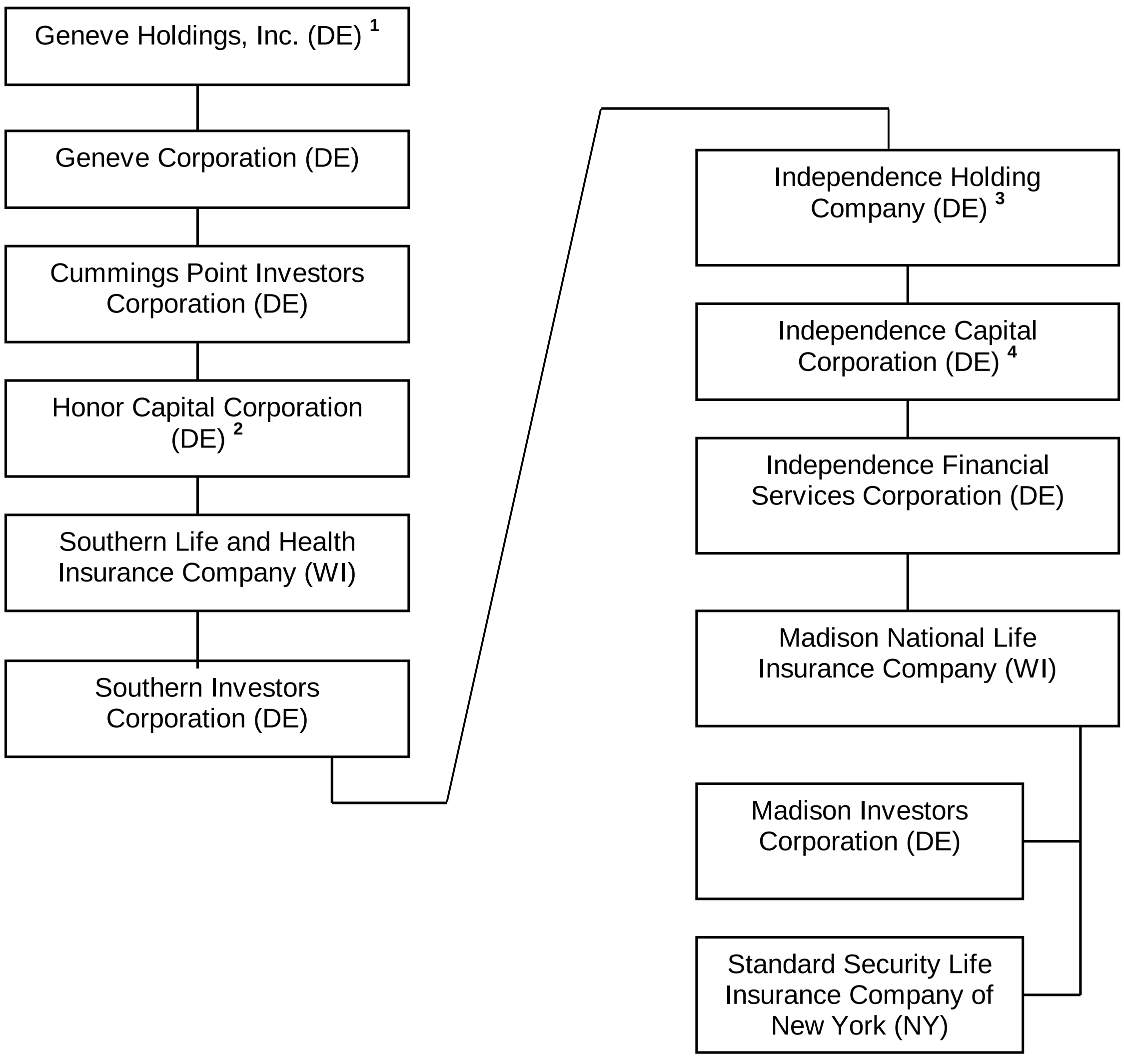
* Amount represents the total salary paid by Southern Life and Health Insurance Company (SLH), an affiliate. MNL reimburses SLH for 70% of their salaries.

@ Salary is paid by IHC and Geneve Corp. MNL paid IHC $267,000 in 1997 for various services including legal services of Mr. Kettig and other personnel, and some accounting services.

IV. AFFILIATED COMPANIES

MNL is a member of a holding company system. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates of MNL follows the organizational chart.

Organizational Chart
As of December 31, 1997



1. Mr. Edward Netter and his family own more than 50% of the voting stock of Geneve Holdings.
2. Cummings Point Investors owns 56.8%, Geneve owns 37%, and Cason Financial Services (not shown) owns 6.2% of the voting stock of Honor Capital Corporation.
3. Southern Investors Corporation and other affiliates own more than 50% of the voting stock of IHC, a public company.
4. IHC owns 99.5% of the voting stock of Independence Capital Corporation.

Geneve Holdings, Inc. (GHI)

GHI is the ultimate parent of MNL and the owner of a large diversified holding company system whose products and services include the retail distribution of health and agricultural products, and financial services and insurance. As of December 31, 1997, the company's audited consolidated financial statement reported assets of $651 million, liabilities of $543 million, and total net worth of $108 million. Operations for 1997 produced net income of $14.4 million.

Southern Life and Health Insurance Company (SLH)

SLH is a Wisconsin-domiciled insurance company located in Birmingham, Alabama. It currently does not write any new direct business. Virtually all premiums are assumed ordinary life and industrial life business. Although their operations are separate, SLH and MNL share two officers, and SLH uses MNL's home office as its statutory home office. The two companies have executed a cost allocation agreement.

As of December 31, 1997, the company's audited financial statement reported assets of $125,989,301, liabilities of $78,949,684, and capital and surplus of $47,039,617. Operations for 1997 produced net income of $7,560,599. The company reported $2,716,094 of net earned premiums.

Independence Holding Company

IHC, a Delaware corporation, is a holding company that is engaged primarily in insurance activities through its subsidiaries. As of December 31, 1997, the company's audited consolidated financial statement reported assets of $455 million, liabilities of $364 million, and stockholders' equity of $91 million. Operations for 1997 produced net income of $11.2 million.

Independence Capital Corporation (ICC)
Independence Financial Services Corporation (IFSC)

In 1993, IHC and MNL management felt that additional surplus would benefit MNL by allowing it to pursue larger acquisitions. Rather than borrow the money itself, IHC created a corporation, which later became ICC, to borrow the $15 million. ICC contributed the money to its newly created subsidiary, IFSC. MNL issued a $15 million contribution note to IFSC in exchange for the funds. Also in 1993, a $5 million contribution note issued by MNL in 1991 was assigned to IFSC. In 1996, MNL issued an additional contribution note to IFSC for $5 million. At that time the terms of the two previous notes were amended so that all three notes mature at the end of 2007 and all have an interest rate of 9 3/8%. In early 1998, IFSC assigned all three notes to ICC.

Madison Investors Corporation

This Delaware corporation was formed by MNL in 1992 to hold or manage assets that MNL might hold or manage directly. As of December 31, 1997, the company's unaudited financial statement reported assets of $8,233,496, liabilities of $3,852,001, and stockholder's equity of $4,381,495. Operations for 1997 produced net income of $449,839.

Standard Security Life Insurance Company of New York (SSLIC)

SSLIC, a 100% owned subsidiary of MNL, is domiciled in New York and licensed to sell insurance in all 50 states, the District of Columbia, and Puerto Rico. The investment in SSLIC represented 20% of MNL's total admitted assets as of December 31, 1997 (down from 45% in 1992). SSLIC is carried at its statutory book value on MNL's annual statement.

SSLIC underwrites Short-term Disability Benefits Law Insurance (a New York state-mandated disability line), as well as group life insurance and stop-loss coverage for companies with self-funded health plans. As of December 31, 1997, the company's audited financial statement reported assets of $135,549,439, liabilities of $87,700,386, and capital and surplus of $47,849,053. Operations for 1997 produced net income of $5,978,294.

Affiliated Agreements

MNL has investment advisory agreements and administrative agreements with IHC. The investment advisory expense for 1997 was $324,000. The administrative expense paid to IHC was $200,000. Other administrative expenses of $267,000 were paid to SLH for MNL's share of officers' salaries and other expenses.

V. REINSURANCE

The company's major reinsurance treaties in force at the time of the examination are summarized below. The contracts contained proper insolvency provisions.

Nonaffiliated Ceding Contracts

1. Type: Excess Quota Share

   Reinsurer: Connecticut General Life Insurance Company

   Scope: Credit life and credit accident and health policies subject to the following maximum issue amounts:

Maximum Age at Issue	Maximum Aggregate Benefit	Monthly Benefit	Maximum Term
18-66	$100,000	$1,000	120 mos.

   Retention:
   Credit Life
   $25,000 each risk.

   Credit A&H
   Issue amounts less than or equal to $200/month—
   100% of issue amount.
   Issue amounts greater than $200/month—
   50% of issue amount.

   Coverage:
   Credit Life
   Issue limit less amount retained.

   Credit A&H
   Issue amount less than or equal to $200/month—
   No coverage.
   Issue amount greater than $200/month—
   50% of issue amount.

   Premium: Based on reinsurer's proportional share of the risk being reinsured.

   Commissions: Expense allowance equal to the commissions actually paid on the direct business, plus 6% of gross premiums.

   Effective date: November 1, 1991

   Termination: Upon three months' written notice by either party.

2. Type: Excess Quota share

   Reinsurer: Reliastar Life Insurance Company (f/k/a Northwestern National Life Insurance Company)

Scope:	Group long term disability subject to maximum benefit of $10,000/month.
Retention:	25% of the risk written.
Coverage:	75% of the risk written.
Premium and Commission:	The proportionate share of gross premiums less the following: • Agents basic commission allowance thereon • An additional agent's commission allowance of 5% on groups of 5 to 50 lives for first year only. • An allowance for company expenses of 9% of the first $4.5 million of premiums and 8.25% of ceded premiums in excess of $4.5 million. • The total aggregate sum of such allowances shall not exceed 28.5%.
Experience refund:	33 1/3% of the net underwriting profits
Effective date:	January 1, 1994
Termination:	On any January 1 by either party giving the other 90 days' prior written notice.

3. Type: Excess quota share

Reinsurer:	Reliastar Life Insurance Company
Scope:	Group Term Life and Accidental Death and Dismemberment.
Retention:	50% of group life benefits up to $50,000.
Coverage:	50% of group life benefits up to $50,000. 100% of all AD&D benefits. 100% of group life benefits in excess of $50,000 to a maximum of $250,000. Benefit amounts in excess of $250,000 shall be submitted to the reinsurer for approval prior to acceptance.
Premium and Commission:	The proportionate share of gross premiums less the following: • Agents commission allowance. • An allowance for company expenses not to exceed 8% of gross premium. • An additional allowance of 7.5% for Kentucky municipal premium tax on first year business only. • The resulting premium shall not be less than 69% of the company's gross ceded premium for any calendar quarter.
Experience refund:	33 1/3% of the net underwriting profits.
Effective date:	July 1, 1993

	Termination:	On any January 1 by either party giving the other 90 days' prior written notice.
4.	Type:	Yearly renewable term
	Reinsurer:	Transamerica Occidental Life Insurance Company
	Scope:	Life, disability waiver of premium, and accidental death benefit policies assumed from Arizona Life Insurance Company.
	Retention:	$25,000 for life and disability waiver of premium policies. None for accidental death policies.
	Coverage:	The net amount at risk in excess of retention.
	Premium:	Pursuant to schedule in contract.
	Effective date:	January 1, 1994
	Termination:	At any time upon 90 days' written notice.

Non-Affiliate Retrocession

1.	Type:	Retrocession quota share agreement
	Reinsurer:	MNL assumes business from and then retrocedes a portion back to Reliastar Life Insurance Company.
	Scope:	Long-term disability risks written by Reliastar through an unaffiliated managing general agent (MGA).
	Retention/coverage:	MNL assumes 80% of the block of business and then retrocedes 68.75% back to Reliastar so that the net risk to MNL is 25% of the risk insured. The maximum benefit under Reliastar's policies shall be $10,000; thus, MNL's maximum risk is $2,500.
	Premium:	Reliastar will pay to MNL 80% of the gross premium received from the policies less 80% of the negotiated compensation paid to the MGA. MNL shall then cedes back 55% of the gross premiums of the entire block less 55% of the negotiated compensation paid to the MGA. Thus, MNL receives a net premium of 25% on the business assumed from Reliastar.
	Commissions:	MNL shall receive a contingent profit commission of 50% of the net underwriting profits, if any, on the business retroceded.
	Effective date:	July 1, 1996
	Termination:	Retrocession agreement terminates when the reinsurance agreement terminates. The reinsurance agreement may be terminated by either party giving 180 days' prior written notice.

Assuming Contracts

As mentioned previously, a significant part of the company's business plan involves the acquisition of blocks of business from other insurers. The acquired business typically involves closed blocks obtained from companies that have discontinued the particular line of business, or blocks acquired from state guaranty funds. The acquisitions are executed as either assumptions or 100% coinsurance. Under an assumption, MNL becomes the primary insurer of the policies upon obtaining written approval from the policyholders, and the policies are reported as direct business of MNL. Under coinsurance, MNL takes over administration of the policies and is contractually responsible for paying claims as a reinsurer, but the primary insurer remains the same. Under some assumption agreements, the entire block is transferred to MNL on the effective date as coinsurance. Then, as policyholders approve assumption certificates, the block gradually becomes the direct business of MNL.

Major assumptions occurring during the examination period are described below.

1997

MNL assumed 100% of the net retained liability of Central National Life Insurance Company of Omaha under a block of single premium credit life and disability insurance for a four-year period. This was a coinsurance agreement. MNL has the option to purchase the block, which involved $10 million of credit life reserves and $8 million of credit disability reserves.

MNL assumed the obligations that National Heritage Life Insurance Company, in Liquidation, had been assuming under a coinsurance agreement with Individual Assurance Corporation (IAC). MNL's agreement with IAC is a coinsurance agreement that switches to assumption upon policyholder approval. The assumed business included $12 million of universal life reserves and $11 million of annuities.

MNL assumed the obligations of American Community Mutual Insurance Company under a block of credit life and disability policies. This block was acquired under an assumption agreement and involved $4 million of credit life reserves and $9 million of credit disability reserves.

MNL assumed a $3 million block of ordinary life business on a coinsurance basis from Unum Life Insurance Company.

1996

The company acquired a large block of pre-need ordinary life insurance and annuity policies from Midland Life Insurance Company under an assumption agreement. This block represented about $33 million of reserves. The company also assumed a block of interest-sensitive whole life insurance with reserves of $7 million from the National Organization of Life and Health Guaranty Associations that had been underwritten by National Heritage Life Insurance Company.

1995 and Prior

The company acquired two blocks of business in 1995 with total reserves of about $3 million. In 1994, MNL acquired two blocks with total reserves of about $1 million.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 1997, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company and the compulsory and security surplus calculation.

Madison National Life Insurance Company
Assets
As of December 31, 1997

	Ledger Assets	Nonledger Assets	Nonadmitted Assets	Admitted Assets
Bonds	$112,199,747	$	$	$112,199,747
Stocks:				
Preferred stocks	11,281			11,281
Common stocks	55,389,660	128,338		55,517,998
Mortgage loans on real estate:				
First lien	247,459			247,459
Policy loans	8,429,270		4,444	8,424,826
Cash	623,270			623,270
Short-term investments	43,015,696			43,015,696
Other invested assets	11,183,715	505,879		11,689,594
Receivable for securities	427			427
Write-ins for invested assets:				
Note receivable on securities sold	600,000			600,000
Other receivables	438,702			438,702
Reinsurance ceded:				
Amounts recoverable from reinsurers		1,934,661		1,934,661
Commissions and expense allowances due		1,317,084		1,317,084
Electronic data processing equipment	131,216			131,216
Guaranty funds receivable or on deposit	1,562			1,562
Life premiums and annuity considerations deferred and uncollected (less loading and reinsurance premiums ceded)		(734,343)		(734,343)
Accident and health premiums due and unpaid		(2,124,894)		(2,124,894)
Investment income due and accrued		987,044		987,044
Receivable from parent, subsidiaries and affiliates		838		838
Other assets nonadmitted:				
Agents' balances	10,061		10,061	
Furniture and equipment	720,855		720,855	
Write-ins for nonadmitted assets:				
Interest maintenance reserve	1,161,511		1,161,511	
Prepaid expenses	78,500		78,500	
Total Assets	$233,002,920	$3,254,618	$1,975,370	$234,282,168

Madison National Life Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 1997

Aggregate reserve for life policies and contracts	$104,367,860
Aggregate reserve for accident and health policies	24,483,030
Supplementary contracts without life contingencies	829,760
Policy and contract claims:	
Life	2,630,104
Accident and health	2,032,419
Policyholders' dividend and coupon accumulations	717,062
Provision for policyholders' dividends and coupons payable in following calendar year:	
Not yet apportioned	168,290
Premiums and annuity considerations received in advance	60,932
Liability for premium and other deposit funds:	
Other contract deposit funds	85,306
Commissions to agents due or accrued	1,753,425
Commissions and expense allowances payable on reinsurance assumed	522,999
General expenses due or accrued	999,667
Taxes, licenses, and fees due or accrued, excluding federal income taxes	415,133
Federal income taxes due or accrued	690,945
Unearned investment income	112,040
Amounts withheld or retained by company as agent or trustee	69,022
Remittances and items not allocated	223,063
Miscellaneous liabilities:	
Asset valuation reserve	4,413,934
Payable to parent, subsidiaries and affiliates	2,474
Drafts outstanding	570,417
Payable for securities	27,702,500
Write-ins for liabilities:	
Other payables	1,993,367
Total liabilities	171,843,749
Common capital stock	3,600,000
Surplus notes	25,000,000
Gross paid in and contributed surplus	909,264
Unassigned funds (surplus)	29,929,155
Total capital and surplus	59,438,419
Total liabilities, surplus, and other funds	$234,282,168

Madison National Life Insurance Company
Summary of Operations
For the Year 1997

Premiums and annuity considerations	$37,582,767
Considerations for supplementary contracts with life contingencies	18,505
Considerations for supplementary contracts without life contingencies and dividend accumulations	98,846
Coupons left to accumulate at interest	1,490
Net investment income	12,163,128
Amortization of interest maintenance reserve	(96,767)
Commissions and expense allowances on reinsurance ceded	4,653,548
Write-in for miscellaneous income:	
Other income	386,544
Assets received on assumption reinsurance	35,121,864
Total income items	89,929,925
Death benefits	11,555,510
Matured endowments	99,234
Annuity benefits	3,550,639
Disability benefits and benefits under accident and health policies	11,009,698
Coupons, guaranteed annual pure endowments and similar benefits	99,234
Surrender benefits and other funds withdrawals	2,341,645
Interest on policy or contract funds	5,359
Payments on supplementary contracts with life contingencies	37,944
Payments on supplementary contracts without life contingencies and of dividend accumulations	182,153
Accumulated coupon payments	3,073
Increase in aggregate reserve for life and accident and health policies and contracts	36,146,926
Increase in reserve for supplementary contracts without life contingencies and for dividend and coupon accumulations	461,284
Subtotal	65,414,637
Commissions on premiums and annuity considerations	8,666,924
Commissions and expense allowances on reinsurance assumed	5,277,090
General insurance expenses	5,439,460
Insurance taxes, licenses, and fees excluding federal income taxes	830,070
Increase in loading on and cost of collection in excess of loading on deferred and uncollected premiums	(18,357)
Total deductions	85,609,824
Net gain from operations before dividends to policyholders and federal income taxes	4,320,101
Dividends to policyholders	108,397
Net gain from operations after dividends to policyholders and before federal income taxes	4,211,704
Federal income taxes incurred (excluding tax on capital gains)	537,723
Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains or (losses)	3,673,981
Net realized capital gains or (losses) less capital gains tax and amount transferred to the IMR	768,235
Net income	$ 4,442,216

Madison National Life Insurance Company
Cash Flow
As of December 31, 1997

Premiums and annuity considerations	$37,558,431		
Considerations for supplementary contracts with life contingencies	18,505		
Considerations for supplementary contracts without life contingencies and dividend accumulations	98,846		
Coupons left to accumulate at interest	1,490		
Net investment income	11,936,463		
Commissions and expense allowances on reinsurance ceded	4,533,312		
Write-ins for miscellaneous income:			
Other income	386,544		
Assets received on assumption reinsurance	35,121,864		
Total		$89,655,455	
Death benefits	9,880,922		
Matured endowments	99,234		
Annuity benefits	3,550,639		
Disability benefits and benefits under accident and health policies	10,170,063		
Coupons, guaranteed annual pure endowments and similar benefits	21,172		
Surrender benefits and other fund withdrawals	2,358,381		
Interest on policy or contract funds	5,359		
Payments on supplementary contracts with life contingencies	37,944		
Payments on supplementary contracts without life contingencies and of dividend accumulations	182,152		
Accumulated coupon payments	3,073		
Subtotal	26,308,939		
Commissions on premium and annuity considerations	7,612,463		
Commissions and expense allowances on reinsurance assumed	4,784,259		
General insurance expenses	4,963,398		
Insurance taxes, licenses and fees, excluding federal income taxes	790,730		
Dividends paid to policyholders	108,397		
Federal income taxes (excluding tax on capital gains)	485,872		
Total deductions		45,054,058	
Net cash from operations			$44,601,397
Proceeds from investments sold, matured, or repaid:			
Bonds	95,176,012		
Stocks	27,390,223		
Mortgage loans	28,899		
Net gains/losses on cash and short-term investments	4,511		
Total investment proceeds		122,599,645	

Cost of investments acquired (long-term only):			
Bonds	$130,193,160		
Stocks	33,689,715		
Other invested assets	6,446,464		
Miscellaneous applications	296,755		
Total investments acquired		$170,626,094	
Net increase (or decrease) in policy loans and premium notes		2,180,568	
Net cash from investments			$(50,207,017)
Cash provided from financing and miscellaneous sources:			
Other sources			20,867,846
Net change in cash and short-term investments			15,262,226

Reconciliation

Cash and short-term investments, December 31, 1996	28,376,740
Cash and short-term investments, December 31, 1997	$43,638,966

Madison National Life Insurance Company
Compulsory and Security Surplus Calculation
December 31, 1997

Assets		$234,282,168	
Less investment in insurance subsidiaries not in excess of subsidiaries' security surplus		9,917,733	
Less liabilities		174,843,749	
Adjusted surplus			$49,520,686
Annual premium:			
Individual life and health	$ 3,157,273		
Factor	15%		
Total		473,591	
Group life and health	34,070,012		
Factor	10%		
Total		3,407,001	
Greater of 7.5% of consideration or 2% of reserves for annuities and deposit administration funds		489,454	
Compulsory surplus (subject to a $2,000,000 minimum)			4,370,046
Compulsory surplus excess or (deficit)			$45,150,640
Adjusted surplus			49,520,686
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million with a minimum of 110%)			6,118,065
Security surplus excess or (deficit)			$43,402,621

Madison National Life Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 1997

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1993	**1994**	**1995**	**1996**	**1997**
Surplus, beginning of year	$22,194,757	$40,468,119	$43,326,544	$48,193,065	$55,681,560
Net income	2,107,212	5,879,978	4,972,293	3,994,292	4,442,216
Change in net unrealized capital gains or (losses)	399,407	(204,496)	444,548	148,361	(25,692)
Change in nonadmitted assets and related items	(48,573)	(1,923,407)	369,759	(987,123)	734,527
Change in reserve on account of change in valuation basis	860,715				
Change in asset valuation reserve	(206,821)	(893,650)	(950,079)	(667,035)	(1,394,192)
Surplus adjustments:					
Paid in	161,422				
Write-ins for gains and (losses) in surplus:					
Contribution note issued	15,000,000			5,000,000	
Surplus, end of year	$40,468,119	$43,326,544	$48,193,065	$55,681,560	$59,438,419

Growth of Madison National Life Insurance Company

Year	Admitted Assets	Liabilities	Surplus
1993	$114,127,397	$ 73,659,277	$40,468,120
1994	115,341,100	72,014,556	43,326,544
1995	124,781,526	76,588,460	48,193,064
1996	166,150,844	110,469,284	55,681,560
1997	234,282,168	174,843,749	59,438,419

Life Insurance in Force (in thousands)

Year	Gross Direct and Assumed	Ceded	Net
1993	$2,769,611	$1,125,001	$1,644,610
1994	4,939,820	2,548,374	2,391,446
1995	4,045,345	1,634,195	2,411,150
1996	4,529,492	1,896,077	2,633,415
1997	5,442,301	2,036,678	3,405,623

Accident and Health

Year	Net Premiums Earned	Net Losses Incurred	Commissions Incurred	Other Expenses Incurred	Combined Loss and Expense Ratio
1993	$11,078,752	$10,955,783	$3,102,899	$1,981,822	144.8%
1994	9,912,601	4,867,695	1,482,001	1,762,174	81.9
1995	11,174,435	6,416,972	1,880,863	2,079,815	92.8
1996	12,009,953	7,617,741	1,842,932	4,548,657	97.4
1997	16,385,683	17,386,295	4,593,452	2,792,331	151.2

As stated previously, a significant part of the company's business strategy is the acquisition of blocks of business. The growth of the company reflects the addition of significant blocks of business in 1996 and 1997. The changes in the accident and health line in recent years are attributable to acquisitions in the credit disability line and growth in MNL's group disability line. With acquisitions, the compensation paid to the ceding company for the acquisition is recorded as a commission expense, resulting in the unusual fluctuations seen in that column. The major acquisitions are summarized in the Reinsurance section of this report.

Reconciliation of Surplus per Examination

No adjustments were made to surplus as a result of the examination.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were 18 specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Articles and Bylaws—It is again recommended that the company comply with its bylaws regarding the number of directors serving on the board.

   Action—Compliance

2. Articles and Bylaws—Pursuant to s. 180.0206 (2), Wis. Stat., it is recommended that the bylaws be amended such that they are not in conflict with the articles of incorporation as regards the number of directors.

   Action—Compliance

3. Articles and Bylaws—In the interest of brevity and clarity, it is recommended that the company file restated articles of incorporation and bylaws with the Office of the Commissioner of Insurance.

   Action—Compliance

4. Investments—It is recommended that all custodial agreements maintained by the company express the liability of the custodian for loss resulting from the negligence or dishonesty of the custodian’s officers or employees, or burglary, theft, mysterious disappearance, damage, or destruction. It is further recommended that custodial agreements provide that the custodian shall indemnify the company for any such loss by prompt replacement of lost securities or lost value.

   Action—Compliance

5. Data Processing—It is recommended that the company execute a formal agreement regarding a disaster recovery site.

   Action—Noncompliance. See the comments in the summary of current examination results.

6. Data Processing—It is again recommended that the company implement the use of a smoke detector in its computer room.

   Action—Compliance

7. Life Insurance Premiums Deferred and Uncollected; Accident and Health Premiums Due and Unpaid—It is recommended that the company nonadmit balances over 90 days past due in future annual statements.

   Action—Partial compliance. See the comments in the summary of current examination results.

8. Life Insurance Premiums Deferred and Uncollected—It is recommended that the company correct the net premium information contained in its data processing system so that the system accurately reports the deferred and uncollected net premiums.

   Action—Compliance

9. Receivable from Parent, Subsidiaries, and Affiliates—It is recommended that in the future the company settle intercompany balances on a timely basis, at least quarterly.

   Action—Compliance

10. Policyholder Dividend and Coupon Accumulations—It is recommended that in future annual statements the company include in the liability for Policyholder Dividend and Coupon Accumulations the interest accrued to the balance sheet date.

    Action—Noncompliance. See the comments in the summary of current examination results.

11. Agency Contracts—It is recommended that the company execute and maintain an agency agreement with Madison Standard Corporation.

    Action—Compliance

12. Aggregate Reserves for Life Policies and Contracts—It is recommended that the company improve its records retention procedures so that detailed valuation runs are available for future examinations for all years of the examination as well as the last year of the prior examination.

    Action—Compliance

13. Aggregate Reserves for Life Policies and Contracts—It is recommended that prior to the end of 1994 the company review all reserve factors and correct those which are incorrect.

    Action—Noncompliance. See the comments in the summary of current examination results.

14. Aggregate Reserves for Life Policies and Contracts—It is recommended that the company review all underlying records to correct errors in the disabled life reserves and that procedures be established to assure that accurate records are established in the future.

    Action—Compliance

15. Dividends to Policyholders—It is recommended that the board of directors annually adopt a dividend resolution determining the dividends to be paid.

    Action—Compliance

16. Dividends to Policyholders—It is recommended that the company's actuary complete the Schedule M Interrogatories and Actuarial Opinion in future annual statements.

    Action—No longer applicable. Schedule M is no longer required.

17. Accounts and Records—It is recommended that the company require sufficient detail from its administrators to support reported figures or that the company require an actuarial certification from the administrators as to the appropriateness of reported assets and liabilities.

Action—No longer applicable. Adequate documentation was maintained for this business. The amount of business administered by third parties has decreased to the point that it is not material.

18. Reinsurance—Pursuant to s. Ins 52.03 (3) (a), Wis. Adm. Code, it is recommended that the company discontinue the taking of reserve credits for reinsurance agreements under which no substantial risk is transferred.

    Action—Compliance

Summary of Current Examination Results

Data Processing

As a result of the previous examination, it was recommended that the company execute a formal agreement regarding a disaster recovery site. The examination found that the company does not have such an agreement in place. Management should review its disaster recovery needs. The company might conclude that the cost of continually contracting for a recovery site is greater in the long run than the extra cost that might be incurred locating a site following a disaster. This would be a reasonable decision assuming it realistically reflects the costs of a disaster and is adequately documented. But, it is a decision that management should make on a proactive basis after thoroughly researching the company's needs and the costs involved. It is again recommended that the company execute a formal agreement regarding a disaster recovery site, or maintain documentation illustrating why management has decided not to execute such an agreement

Short-term Investments

This asset included several non-negotiable certificates of deposit (CDs). According to the NAIC Annual Statement Instructions--Life and Accident and Health, non-negotiable CDs should be reported as cash in Schedule E. No reclassification will be made for purposes of this report due to materiality. However, it is recommended that in future annual statements, the company report non-negotiable certificates of deposit as cash, rather than short-term investments.

Life Insurance Premiums Deferred and Uncollected

These assets consist of premiums receivable on direct business and reinsurance assumed, less unpaid reinsurance premiums on ceded business. Credit insurance is processed much like property and casualty insurance, with agents collecting premiums and then submitting them upon being billed by the company. The previous examination disclosed that there were balances over 90 days' past due, and it was recommended that the company nonadmit these in future annual statements. As of December 31, 1997, the company properly nonadmitted overdue accident and health premiums, but life insurance premiums over 90 days' past due were included in this asset. It is again recommended that the company nonadmit balances over 90 days' past due in future annual statements. No adjustment will be made due to immateriality.

Aggregate Reserve for Life Policies and Contracts

As stated previously, OCI contracted with an independent actuary to assist in the examination of policy reserves. The actuary found various weaknesses in the company's traditional life reserves including missing and incorrect reserve factors. To correct for the weaknesses, the company made adjustments, both positive and negative, to the reserve totals for certain plans and distributed an additional margin among all plans, with the aggregate adjustment being a decrease of $250,000.

The previous examination found similar weaknesses in the life reserves, and it was recommended that the company correct the errors by yearend 1994. The numerous errors found in the December 31, 1997, reserves indicate that the company was not in compliance with the prior examination recommendation. However, the company converted its life reserves to a new system in 1998. At the examiners' request, the company provided a calculation of 1997 traditional life reserves using the new system. The calculation showed that the new system eliminated the weaknesses and the reserves reported as of December 31, 1997, were adequate.

Aggregate Reserve for Accident and Health Policies

Under s. Ins 3.17, Wis. Adm. Code, the reserve for open long term disability claims is to be calculated using the 1987 Commissioners Group Disability Table (1987 CGDT) for claims incurred in 1992 and later, except that the insurer may base the reserve on experience for claims less than two years old. When calculating this reserve, MNL applied the 1987 CGDT only to Michigan and Wisconsin policyholders' claims incurred in 1992 or later (as opposed to all claims incurred 1992 and later). The resulting difference between the two methods was not considered material. However, the Wisconsin valuation law and related rules apply to all reserves, not just reserves for Wisconsin policies. It is recommended that the company comply with s. Ins 3.17, Wis. Adm. Code, by applying the 1987 CGDT for all open long term disability claims incurred on or after January 1, 1992. The company may use another methodology for claims less than two years old as allowed by the rule.

Policyholder Dividend and Coupon Accumulations

As a result of the previous examination, it was recommended that the company include in this liability the interest accrued to the balance sheet date. The balance reported as of December 31, 1997, did not include such accrued interest. It is again recommended that in future annual statements, the company include in this liability the interest accrued to the balance sheet date. No adjustment will be made, as the amount was immaterial for purposes of this report. In 1998 the company began using a new system which automatically accrues the interest to the reporting date. Management believes that this will assure compliance with the above recommendation in future years.

Remittances and Items Not Allocated

The company included in this liability several debit balances which were placed in suspense accounts many years ago. The balances are related to an acquisition of a block of business. Management has not taken steps to clear the suspense balances. It is recommended that the company either allocate the old debit balances to other accounts or write them off. The total of the balances is immaterial, and management has indicated they will likely write them off.

Reinsurance

As described earlier, MNL assumed the obligations that National Heritage Life Insurance Company, in Liquidation, had been assuming under a coinsurance agreement with Individual Assurance Corporation (IAC). MNL's agreement with IAC is a coinsurance agreement that switches to assumption upon policyholder approval. The assumed business included $12 million of universal life reserves and $9 million of annuities as of December 31, 1997. In Schedule S, Part 3C, Section 1, the company reported the life business, but did not include the annuity business and some miscellaneous reserves for riders. It is suggested that the company use greater care in completing Schedule S of future annual statements.

Accounts and Records

During the examination of some accounts, the company had to employ considerable effort to provide documentation that supported annual statement balances. For policy loans, the balance was derived from several reports. After considerable delay, the company was able to recreate a calculation that produced a result that was close to the amount reported. For other invested assets, the company was able to provide documentation of its equity in three limited partnerships only after months of delay and several communications with its investment manager. It is recommended that the company maintain adequate work papers supporting annual statement balances, such that requested documentation can be produced promptly.

VIII. CONCLUSION

MNL's premium volume and surplus grew significantly during the period under examination, and the company was consistently profitable. Much of the growth was attained through the acquisition of blocks of business from other insurers and from state guaranty funds. Total capital and surplus grew from $22 million as of December 31, 1992, to over $59 million as of December 31, 1997.

Some of the company's growth was due to the issuance of $20 million of surplus notes during the period under examination. The company now has a total of $25 million of surplus notes. The notes all mature at the end of 2007 and have an interest rate of 9 3/8%. The purpose of the additional surplus was to enable the company to pursue more and larger blocks of business. The company has remained current on interest payments. Repayment of principal and interest is subject to the approval of the Office of the Commissioner of Insurance.

The examination resulted in seven recommendations and one suggestion, three of which were repeated from the previous examination.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 27 - Data Processing—It is again recommended that the company execute a formal agreement regarding a disaster recovery site, or maintain documentation illustrating why management has decided not to execute such an agreement.

2. Page 27 - Short-term Investments—It is recommended that in future annual statements, the company report non-negotiable certificates of deposit as cash, rather than short-term investments.

3. Page 28 - Life Insurance Premiums Deferred and Uncollected—It is again recommended that the company nonadmit balances over 90 days' past due in future annual statements.

4. Page 28 - Aggregate Reserve for Accident and Health Policies—It is recommended that the company comply with s. Ins 3.17, Wis. Adm. Code, by applying the 1987 CGDT for all open long term disability claims incurred on or after January 1, 1992. The company may use another methodology for claims less than two years old as allowed by the rule.

5. Page 29 - Policyholder Dividend and Coupon Accumulations—It is again recommended that in future annual statements, the company include in this liability the interest accrued to the balance sheet date.

6. Page 29 - Remittances and Items Not Allocated—It is recommended that the company either allocate the old debit balances to other accounts or write them off.

7. Page 29 - Reinsurance—It is suggested that the company use greater care in completing Schedule S of future annual statements.

8. Page 30 - Accounts and Records — It is recommended that the company maintain adequate work papers supporting annual statement balances, such that requested documentation can be produced promptly.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employes of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Denis Fuerstenberg	Insurance Examiner
Eleanor Oppriecht	Insurance Examiner
Cruz J. Flores	Data Processing Audit Specialist

Respectfully submitted,

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